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BODY:

JOINT ECONOMIC COMMITTEE HOLDS HEARING ON IRAQ'S ECONOMY

JUNE 11, 2003

SPEAKERS:

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BENNETT: The committee will come to order. I have a prepared opening statement which has been distributed. And I don't back away from it, but I am going to deviate from it a little in the actual remarks that I make to kick off the hearing, because I think the best demonstration of the atmosphere in which this hearing is being held comes from this morning's paper.

Here is the Washington Post, a picture. And it says in holy city, things are going right. U.S. forces and Iraqis work together in Shiite stronghold of Karbala. The New York Times, however, GI's in Iraqi city are stalked by faceless enemies at night. And the lead says, since the American command quadrupled in military presence here last week, not a day has gone by without troops weathering an ambush, a rocket propelled grenade attack, an assault with automatic weapons or a mine blast.

BENNETT: Reminiscent of the war when we won it on Fox but lost it on CNN. There is a constant sense of instant conclusion that goes on in the media. We must know, preseason, who is going to win the World Series. We must know, preseason, which two teams are going to go to the Super Bowl and which one is going to win. We have national rankings of college basketball teams before the first dribble is ever bounced on a hard wood floor. And we carry that same sense of determination to announce outcomes immediately over into politics. So everything's going well in one newspaper. Everything is a disaster in another newspaper. We're going to triumph. There is no hope. Pick your paper, or pick your conclusion.

The purpose of this hearing today is to get above that kind of babble of voices one way or the other and recognize that we will not know whether we have succeeded in establishing a democratic, stable regime in Iraq for a year, two or even longer. The implications of that quest, the desire to replace a brutal tyranny and harsh dictatorship with a functioning, stable government ready to join the world and participate as a true partner in the world economic structure has enormous implications for the United States. It has enormous implications for our economy. But it has even bigger implications for the world at large.

The establishment of a peaceful, stable and economically viable Iraq will transform the Middle East if it is successful. If it is not, we will pay a price that is almost incalculable at this point. So I want to say to everyone who is listening. I don't think I need to say it to our witnesses who are

testifying. That if you have come here to try to get the latest answer for are we making progress in getting the water turned on, will the electricity be available by next Friday, where are we in finding the latest artistic treasure, this is not the hearing for you. This is a hearing to be discussing very long-term prospects and very long-term strategies to help the Congress, and we hope through the Congress, the American people, and yes, if I may be so bold, the administration to understand some of the strategies that might work, some of the strategies that should be avoided and overall the opportunity and challenge that we are presented with.

There has never been a time in history where more is riding on a successful post war kind of activity. Now I say that looking back, that's probably not true if you look at the accomplishments that followed the Second World War. But the Second World War kicked off an entirely different international situation. As we followed the Second World War, we went into the cold war where there was a polarization of forces with the United States and the other countries of the West on one side, the Soviet Union and its satellites on the other. And the successes that were achieved in Japan and South Korean in taking what had not been a democratic society and turning it into a viable, modern state occurred within the frame work of the cold war challenge.

Now we are in a world where there is only one super power. But there are a multitude of non-state powers that would seek to destabilize the world through acts of terror. And how things come out in Iraq can have an incredible impact on whether or not we get on top of that new kind of world.

So that's the background against which we meet this morning. Those are the issues that we intend to explore. And we have assembled, I believe, an outstanding panel of experts to help us do that.

Now with that, we are joined by Mr. Stark, the ranking member. And I will yield to him for an opening statement. And I would ask consent of the committee -- our normal pattern is that we have opening statements only from the chairman, the ranking member and the vice chairman. But I would ask that Ms. Maloney be recognized for a brief opening statement, because she has to leave us and wants to be part of this to the degree that she can. So if there's no objection, following Mr. Stark, then I will hear from Mr. Saxton and then Ms. Maloney.

Mr. Stark?

STARK: Thank you, Mr. Chairman. And I want to commend you and pay homage to your creativity in holding this hearing at this time. It's an important topic. And it's an important responsibility that the president has put on the shoulders of the American taxpayers, or should I say debtholders since this administration doesn't believe in taxes.

And as I was pondering my thesis for my doctorate in theology at Bob Jones University, I'm a humanist, and therefore, the hereafter doesn't mean much to me. I keep looking for heaven on earth. But one of the problems of doing that is I could never find a place for right wing Democrats or Republicans either. And it came to me as I was reading Hendrick Hertzberg's New Yorker article, which I'd like, Mr. Chairman, to put in the record...

BENNETT: Without objection.

STARK: ... that it's Iraq. Why, it's a supply-sider's dream. There are no taxes. There are no environmental regulations to get in the way of you free enterprises. Why, religion is the government. There is no separation of church and state. I have never seen a place where a free market economy is running amuck. Charleton Heston would love to go there. Everybody's got a

gun. He could organize an IRA and be there. Why, the club for growth ought to build their national headquarters there.

I just think, Mr. Chairman, that this is the nirvana for the supply-siders and the right wing Republicans. Now I'm afraid that's not what we're going to hear from our witnesses today. And the facts are that Iraq's economy and the civilian society is a mess. And I suspect we have a long and expensive reconstruction ahead of us. I don't think we should be surprised if the administration had put as much time into preparing for the inevitable problems instead of preparing their public relations campaign to get us to invade and preparing a prime time for movie with that Lynch person, why, maybe we'd have had some ideas. But that's not what happened. And we have to pick up the pieces.

So we'll hear some creative ideas from our panel. But I hope they won't lull us into thinking this is just going to be easy. I think it's going to be expensive and long-term. And I hope you'll be very honest with us so we can be honest with the American public, for a change and tell them what the consequences -- because I'm afraid if we don't change our domestic policy soon that our next hearing will be on restructuring the American economy.

And I thank you, Mr. Chairman. And I look forward to the testimony of our witnesses.

MALONEY: Thank you, Mr. Chairman, so very, very much.

BENNETT: I was going to Mr. Saxton. But if...

SAXTON: She can go if she wants. That's OK.

BENNETT: All right. Mr. Saxton yields to you, so go ahead.

MALONEY: Thank you so much, Mr. Chairman and Mr. Saxton. At this point, I'm supposed to be a ranking member at a Financial Services Committee. But I feel this is a tremendously important hearing, and I ask permission to revise and extend my remarks and just briefly say that in this hearing we will hear several approaches for studying the groundwork for reconstruction. One issue that I believe should be a significant part of the discussion is debt relief. As we have seen in post war Germany, debt relief can be an essential tool in rebuilding a nation destroyed by war and humiliated by its leadership.

We have also seen in recent years that debt relief is an effective development tool that releases funds within a nation that can be used to address poverty and meet essential human needs. The case for some, debt cancellation is even more compelling in Iraq given that much of the debt can be characterized as odious. Odious debt is internationally recognized as debt that is taken on by a country for the personal benefit of corrupt leaders or for the oppression of a people. Clearly much of the Iraqi debt falls in this category.

To address the issue, this week I will introduce legislation in the House calling for debt relief from Iraq's international debts, including funds it owes the World Bank and IMF. Who should pay debt that Saddam owes? How can we ask the people of Iraq who lived in fear of Hussein's secret police to pay back the loans that supported these armed assassins? You don't have to travel far outside of Baghdad to see a sprawling slum called Saddam City that houses 2 million Shiite Muslims. The slum is overrun with garbage, and children climb the mountain of refuse to look for scraps of food or things that could be traded for food or clothes. In the face of this poverty, the Iraqi regime spent billions of loaned dollars on palaces and other luxuries. What better way to enhance our efforts at reconstruction and empower the people of Iraq than debt relief?

If Iraq is ever truly to be a peaceful and prosperous democracy, its citizens must be allowed to start anew. Fifty years ago, 20 nations led by the U.S., England and France agreed to forgive half of Germany's pre- and postwar debt. The so-called London agreement proved to be the right course. Debt cancellation for Germany was a very important part of the Marshall Plan which helped the country become a strong and prosperous democracy post World War II. This approach can aid Iraq as well.

In addition to odious and other debt that Iraq owes, public and private world creditors, the IMF and World Bank are priority Iraqi creditors. When nations service their external debt, they will pay the IMF and World Bank first.

While estimates of Iraq's debt range from \$100 billion to several hundred billion, the combined debt owed the IMF and World Bank is just over \$150 million. These institutions have the resources to relieve the debt, setting an important precedent for the rest of the world. For this reason, I will be introducing the Iraqi Freedom From Debt Act, legislation to require the U.S. to negotiate in the IMF, World Bank and other appropriate multi-lateral development institutions for the IMF and World Bank to relieve the debts owed by Iraq to these institutions.

Furthermore, this legislation includes a sense of Congress that the president should urge France and Russia and all other public and private creditors to relieve the debts owed to them by Iraq. By taking the lead on debt relief, we have an opportunity to do the right thing for Iraq's economy and to prove to the world that the major reason for war was to benefit the Iraqi people.

And I yield back the balance of my time. And I thank you for this consideration. And I hope that you would consider possibly looking at this legislation for the Senate.

BENNETT: Thank you very much. We appreciate your contribution. And we will take a look at the legislation when it comes over.

Mr. Saxton?

SAXTON: Thank you. It's a pleasure to join in welcoming the witnesses. Before Ms. Maloney departs the room, I think her position and mine are fairly close on the Iraqi debt. In fact, last week I introduced a bill which is now H.R. 2338 which sounds very close to what you have just outlined. And I'm going to speak a little bit more about that. So I look forward to working with you.

MALONEY: I wish I could stay, but I am (OFF-MIKE)

SAXTON: That's OK.

MALONEY: (OFF-MIKE).

SAXTON: Mr. Chairman, during your opening statement, you referenced the development of a long range strategy to promote Iraq's economy which has been sinking for years under the rule of Saddam Hussein. I'd like to talk about at least one important piece of what could become that long-term strategy. The economy in Iraq has for years been doing very poorly. Extensive ownership, control and influence of business by the government, its officials and political cronies undermined economic growth. Iraq's invasion of Kuwait resulted in economic sanctions and the Oil-for-Food program.

SAXTON: And although the recent war has resulted in some economic damage, Iraq's economic situation today is quite similar in my opinion to the Eastern European countries after the collapse of the Soviet Union.

New institutions are needed that are compatible with a market economy and improve prospects for economic growth. The prospects for Iraq's economic recovery are clouded by an unsustainable debt burden that Ms. Maloney was just referring to. One of the major challenges to improve the potential of the Iraq economy is the heavy burden of foreign debt accumulated under the regime of Saddam Hussein. The hated regime is gone, but the financial legacy should not continue to oppress the Iraqi people undermining their economic potential. Forgiving much of Iraq's foreign debt is the right thing to do. But foreign creditors may be hesitant if they anticipate an opportunity for bailout indirectly through the IMF or the World Bank. A write-down of at least part of Iraq's debt would greatly improve Iraq's economic outlook.

Under legislation I have recently introduced, Iraq's creditors would be encouraged to forgive much of Iraq's outstanding foreign debt rather than to wait for a potential bailout from the IMF or the World Bank. This legislation of which this is a copy would mandate that safeguards be in place to ensure that lending by these institutions could not be used to repay Iraq's creditors thus encouraging a more timely write-down of some of Iraq's debt and protecting taxpayer money.

As I have pointed out many times before, the IMF should not be used as a bailout agency as this practice creates a potential for misuse of IMF funds. Taxpayer money should not be used to bail out investors of high risk ventures. There is a role for the IMF and the World Bank in Iraq, but it should be carefully defined to ensure that past mistakes are not repeated.

With adoption of appropriate institutional reforms and market oriented economic policy, Iraq's people could look forward to a better future. The IMF and the World Bank can be useful in this regard, but not if the money is to be just funneled through to Iraq's creditors.

Thank you, Mr. Chairman.

BENNETT: Thank you very much.

We'll now go to our panel of witnesses. And I'm quite excited about the witnesses that have agreed to appear today. I know you would all like to give us something of a seminar. And we would undoubtedly benefit therefrom. But if each witness takes 15 or 20 minutes, we'll be in some trouble, time wise. And we would hope to have some interaction with the witnesses.

Now our normal pattern is five minutes. Some of you may have a little more to say than that, and I'll be a little generous. But if you start tending towards 10 minutes, why, I'll begin to tap the gavel and ask you to summarize if you can so that we can get the kind of interaction that we would hope for from this panel.

Our panelists today are Mr. Basil Al-Rahim who is of Iraqi heritage. I believe he was born in Iraq. He's an investment banker, founder of the Iraq Foundation. Mr. Hernando De Soto, the Institute for Liberty and Democracy, a best selling author and adviser to a wide range of governments. Dr. David Ellerman, he is an economist recently retired from the World Bank and Dr. Rachel Bronson who is Director of Middle East Studies from the Council of Foreign Relations.

So I think this gives us a wide spectrum of background and understanding. And we look forward to hearing from you all.

Mr. Al-Rahim, we will begin with you.

AL-RAHIM: Mr. Chairman, thank you very much. You've asked me to speak on transforming the Iraqi economy. It's a huge subject. I'll try to summarize some salient points in five minutes or so. And I apologize that I will miss a lot of the details obviously.

First, let me say there are four points to my presentation. One is that we need a full economic program, and it cannot be a haphazard transformation of the economy. The program has to be well thought out, comprehensive, transparent and elaborated to the public, both here and in Iraq. I have called this program the Phoenix Plan because rehabilitating Iraq will be like rehabilitating an Olympic athlete that can compete, not rehabilitating a cripple that can just at best just walk.

Second point is that oil alone is definitely not a panacea. While Iraq has huge reserves, these are underground and don't do the man on the street much good.

Third point is that the solution to transforming the Iraqi economy is empowering the private sector. There is no escaping this.

The fourth point is that the plan must be implemented by an independent commission of technocrats with the ability to fast track the regulatory approvals necessary to underpin this plan.

Let us remember that Iraq has four very important resources. First is oil which we all know about. Second Iraq has water: two major rivers in an otherwise arid part of the world. Iraq has very fertile land and has achieved self-sufficiency in food production in the past and can do so again. Fourth and most important, Iraq has a large technical, professional labor force made up of engineers, doctors, lawyers, teachers, et cetera. And it has experienced a very severe brain drain which needs to be reversed.

The economic blueprint that I'm calling the Phoenix Plan is an economic model for Iraq, the region and the future. It will counter the regression that Iraq has gone into back into the 19th century and bring it back into the 21st. By empowering the private sector and using oil revenue as a catalyst, I believe that this plan can be implemented.

It should have three phases: an immediate phase, removing bottlenecks in the economy, a medium term plan, five years where we detail plan targets such as production, industry, banking, health, education with a target GDP per capita of \$10,000. And it should have a long-term 10 year objective of a GDP per capital of \$20,000 which is where Iraq should be had it grown normally during the last 20 or 30 years of the Baath regime.

The state should act as a facilitator and enabler. Monetary and fiscal policy have to be proactive to support the plan. Debt resolution is very important, as Mr. Saxton mentioned. Debt has to be recognized into three categories: bonified commercial debt, government debt and war reparations. Each one needs to be treated entirely separately. And absolutely much of it must be forgiven.

The components of the plan fall into a number of sectors. Of course the oil sector is the major one. Big oil expertise and capital are definitely needed. However, the Iraqi private sector must be a partner in this exercise. Though negotiations are difficult, they are between unequal partners. We must get the state out of the oil sector as the experience of the state in oil has been a bane to nations and never a boon.

There is the issue of whether Iraq should stay in OPEC or not, and that needs to be thought through very carefully. Iraq has no interest to create price wars in order to obtain market share. But it cannot be tied to rigid allocations that no longer apply.

The downstream sector is also very important. But that also will require additional capital. Downstream sector is valuable, not only in job creation, but also in improving the revenue added value of exports.

The whole issue of privatization has to be explored. There are dangers and advantages to privatization. But this is the way to get what amounts to the majority of the productive assets of the country back into private hands. There are many challenges as to how do you value assets fairly in this time, how do you attract foreign investors, how do you achieve growth distribution, how do you avoid the problems that befell Eastern Europe when people started out with a voucher and ended up with a bottle of Vodka, and that was the extent of their participation in the economy.

Debt forgiveness and rescheduling, as I said, is critical. We see the three categories. Commercial debt has to be renegotiated. Government debt has to be forgiven, because it was extended to the old regime, as Ms. Maloney called it, the odious debt. And war reparations have to be recognized, because somebody did actually suffer at the end of this adventurism by Saddam Hussein.

The plan proposes trading some of this debt for a point system that can be then used for concessions, licenses, contracts. The point system itself would start having a market value and be traded between people who want to buy those points for use in Iraq on their own. Therefore, you don't eliminate the value of those points, but you shift them to the free market.

Attracting foreign direct investment, a next aspect of the plan is critical. And there are very many issues on this. One of the important issues is to avoid economic pillage of the country by foreign investment, which will definitely happen if we are not careful. Restitution of private property has to be a part of that plan. And that has resulted from the 1963 nationalization and just continued through various ways of government.

Currency stabilization is critical. And new Iraqi dinar pegged to the dollar and the euro has to be introduced. The banking sector is very rudimentary. The banking sector is made up of two banks, two government owned large banks and 18 small private banks. This must be modernized, upgraded. Joint venture banks have to be attractive to help rebuild the banking sector, which is a critical part of any economy.

A final component of that plan we can look at is the capital markets themselves. There is something called the Baghdad Stock Exchange. It's been around for many decades. That has to be expanded, deepened and broadened. And that can be done by linking privatizations with aesops (ph), with IPO's and with other forms of participation in the public market.

There are three other critical issues. And I apologize if I'm running on the time. First and foremost, critical to this plan is the employment and empowerment of the private sector. The population has been reduced to poverty subsistence over the past 20 years. The transition to a free market economy and full membership in WTO, which should be the objective of Iraq, cannot happen overnight, because we need to protect the population to make sure not to disenfranchise them from the wealth of the nation.

Vocational training centers have to be set up so that 400,000 soldiers decommissioned from the army can be brought back in a productive manner into the labor force. We have to avoid the problem of oligarchs and cronyism that we've seen in other parts of the world. And these are already beginning to cluster around Iraq.



Vulture (ph) regional and international wealth (ph) investors are looking very closely at Iraq. And these have to be prevented. Finally, while WTO has to be the objective, the plan has to recognize how we move to that objective step by step. There has been much talk in the press about something called the Iraq Development Fund. We don't know what the mandate of that fund is. We don't know what the governance and oversights of that fund are. And I would suggest that the mandate should be synergistic with the overall plan. The governance and oversight has to be transitioned to full local authority once a legitimate government is in place.

There are models that we can look at. The Alaska Fund has been mentioned as one model. And some aspects of that fund are attractive, not all are relevant. The Oil-for-Food program has been a resounding failure, in my opinion, in the last number of years and should not be followed. But there is also something called the Iraqi Development Board which was set up in the 1950s which has some very clear attractions, because it was able to take part of the oil revenues away from the government budgets completely and use them only for development work. And that's a program that needs to be clearly examined.

We need to deregulate infrastructure, some parts of it fast and get the state out of there. The fast parts can be transportation and telecom and media. Over the medium term, the government should get out and deregulate power and water. And it should partially deregulate but stay partially involved in health care and education.

In closing, I would like to say what is the role of the United States and other players in the transformation of the Iraqi economy. It is critical that the United States does not abandon its leadership role in Iraq. Iraq needs a strong open markets patron and partner with a shared vision for its transformation and cannot become a beacon for the region without U.S. help. G8 countries do have a role and should be brought in, because they can bring diverse values that can help rebuild the country.

The Gulf cooperation countries, Iraq's neighbors should be encouraged to supplement the limited financial and industrial absorption capacity of their own economies by participating in the Iraqi market. And finally in conclusion, I would like to say that the Phoenix Plan requires independent technocratic commission with the ability to fast track implementation and regulations. A healthy economy in Iraq is a prerequisite for a stable democracy. And both are mutually reinforcing.

AL-RAHIM: The domino effect can happen, and we have to be careful which way it tips. Empowering the private sector is the only solution. Albeit important, oil is only one part of the equation. The price of losing the peace is not limited to Iraq or even the region, and time is of the essence. Thank you very much.

BENNETT: Thank you, sir. Appreciate that.

And Mr. De Soto?

DE SOTO: Thank you very much, Mr. Chairman. First of all to tell you how much I appreciate your comments on the fact that so much is at stake in Iraq. All the eyes of the world are on Iraq. And in effect, if there is not a successful transformation there, that will definitely bolster the arguments of all those people who are already marching on the streets against globalization, against the values of a free society, a market society and the possibility of creating capital. And if you aren't able to do it in Iraq, the question then will be are all countries made for that kind of freedom.

They're not. Obviously it can't even work even if the foremost power of the world is involved. So a lot is at stake.

And I think a very important comment was also made by Mr. Saxton which is that the important thing here is not to repeat mistakes. And that's why it's very useful to look at history and see where mistakes have been made.

One of the interesting things about listening to Mr. Al-Rahim, both in a conversation previous to this meeting and here is that what he says about Iraq is well known and is absolutely true. There is a large technical and professional class in Iraq. And there is an elite, like, of course, there was in Cuba, and there was in my country, and there was in Venezuela, and there was in Egypt. Now why did we get off the track 40 years ago? And I think that's important to remember. And we're off the track, because we had people who could actually participate in a capital society were, in spite of an elite, a minority. And when there are minorities, when it's only 20 percent of the population, 30 percent or 15 or 5 percent of the population that is in an elite position to benefit from a capital society, it becomes what I call mercantilism. It becomes something that is politically unsustainable.

So if all of this is about is restitution, in general one must be very careful, because what it does mean is restituting an elite and (INAUDIBLE) people feeding themselves on the outside will then go for one of these -isms, whether it's called socialism or whatever it is to go for redistribution. Because that's the reason that though capitalism has been around for such a long time, it has failed in our countries. It hasn't redistributed opportunities quick enough. And that's really the history of the world. In the United States, Japan, Germany, Switzerland and France, capitalism came but with large legal efforts to make sure that everybody could come and find the game. And where there were elites but that did not distribute these possibilities, whether it be Russia and everything that is a former Soviet Union, these collapsed. And they will continue to collapse, because they're not politically sustainable.

Nobody on the outside, as Mark said, will feel that they're participating. They will feel alienated. And that's how revolutions start. Whether there's a Kremlin to organize them, whether Beijing is around to organize them, or whether they're not there. The interesting thing is also not only the bad experiences of history also, but the good experiences of history.

One of them, for example, is your own history in Japan when the United States won the war against Japan, occupied Japan in 1945. What it did there that was good is useful to remember. People sometimes forget what state Japan was in during the '30s and the '40s. For us Peruvians, of course, it's relatively easy, because we have had a president of Japanese origin from the year 1990 to the year 2000, President Fujimori who was a member of one of the one and-a-half million Japanese families who migrated to South America in the '30s and the '40s, especially to Peru and Brazil which were open to Asian migration. And the reason the Fujimoris migrated to Peru, and the reason why the De Sotos did not migrate to Japan was because we had a GNP per capita that was higher than Japan's, 20 percent higher in the case of Peru, 40 percent higher in the case of Brazil.

The interesting thing is that now that President Fujimori has returned to Japan is that he has found a Japan which is now 10 times richer than any other Latin American country. And the question then is what did Japan do between 1945 and today to become 10 times richer than us Latin Americans who before used to receive their migrants because they were poor. And reply is that they created a capitalist system, but where everybody could participate. And that required a plan. And that plan was originally set up by Americans working since 1942 in Honolulu to make sure that

the feudal class did not recuperate all its privileges and that property rights were widespread. As a matter of fact, they were already widespread, but at an extra legal level. But the legal reforms that took place in Japan between 1946 and 1950 made sure that capitalism was a popular enterprise the way it is today in the United States instead of being an oligarch enterprise the way it is in most developing countries, and therefore, falters.

So the ideas and the virtues of the American economy and your political system have been around for certainly more than 200 years. And we've tried to imitate them. The problem is we have never been able to distribute them equally. And that's why it's important to have a good look at that.

So one of the first things I think that should be done is to get the facts. What do you have to do to popularize a capitalist economy, to make it democratic? As you know, some of the work that we are doing in different countries, our think tanks which you have so generously supported in the U.S. Congress has gone to go to countries like nearby Egypt where we've been contracted by the government, and the government has made public the numbers I am going to give, therefore, I am not breaking anybody's confidence. And though I know that Egypt is not Iraq, but Egypt is not very different from the other Asian and Latin American countries that we've been working in. We have found that in places like Egypt the extra legal enterprises, small and medium enterprises and what are generally poor people actually hold a large amount of assets. The problem is they don't hold them within the law. And as a result of which, of course, they cannot become fungible or liquid. They cannot become capital.

But what we did find out is that in Egypt about the Egyptians or the poor sector of Egypt owns about \$245 billion worth of assets only in small enterprises and lands and buildings. And how big is \$245 billion? Well, it is 55 times the size of all foreign direct investment. In other words, a lot of the resources that Egypt and Iraq may need to get ahead are already within those countries. They are much bigger than foreign direct investment.

Another interesting fact: they are 50 times bigger than all World Bank loans given to Egypt. So no matter how much aid you give, public or private, already inside that country the poor may be holding their assets, albeit, illegally. They can't really get into the official market, the expanded market and be traded in a way that they can be leveraged and actually create major wealth.

In the case of Mexico, for example -- and by the way, excuse me, one last point. All the assets of the poor in Egypt are 30 times bigger than the Cairo Stock Exchange. So it would be interesting to find out if in Iraq, in spite of all the turmoil and all the problems, already the poor have not got a stake. And that stake, instead of being withdrawn should be enhanced.

In the case of Mexico, which is another oil producing country, it turns out that what the poor have also outside the law is about \$315 billion worth of assets. And the interesting aspect of it is that today Mexico, of course, produces more oil than Iraq and has been doing so for over 10 years. These assets that belong to the poor are seven times higher than Mexico's known oil reserves. So the mistake that one -- the important thing here that you said in your declared statement is that property rights are crucial. Who gets the property rights? How does the legal system recognize them or not recognize them? Because at the end, if people see that the law protects their rights, and what they have today as assets and allows them to leverage them, then of course, the rule of law can come into place, because I will understand the rule of law in the measure that it protects whatever assets I have, whatever capital I have, no matter how insignificant it is.

And the clue to all of that, of course, Mr. Chairman, is inclusion. There are exclusive capitalist systems, what Mr. Al-Rahim called oligarchs and cronyisms. And there are democratic and popular capitalism. And it's very important to ensure now that the eyes of the world are on Iraq that that's the kind of capitalism you get.

BENNETT: Thank you very much.

Dr. Ellerman?

ELLERMAN: Thank you, Mr. Chairman. I'm here to speak about some of the lessons learned from the transition economies, former Soviet Union, in particular. And I think the short story is that the intervention of the international institutions World Bank to (ph) fund Western academics, economic profession in the former Soviet Union in the nation building effort there was a disaster, was a debacle. And the recently appointed head of the council of economic advisers is Greg Mankiw from Harvard just published a piece on this and was a bit agnostic about assigning the blame, but said if, in fact, this shock therapy and the voucher privatization was wrong, then it was a blunder of historic proportions, one of the biggest blunders in world history. But he was a little soft on us on assigning responsibility, because it was a lot of his Harvard colleagues.

So the question is what did we learn from that. What are the lessons that we can take away from that experience? And one has to go back to the sort of mentality of the intervention. It was one where it was at the revolution that socialism had failed. And the (INAUDIBLE) was sort of a cold warrior self righteousness of let's wipe the slate clean of everything from the past. Let's try to start over. Let's try to create a new society, a heaven on earth. And this is something that (INAUDIBLE) know doesn't work. You can't do this overnight. The Jacobians tried this in the French Revolution, the Bolsheviks in the original Russian Revolution. And yet the United States backed the market (ph) Bolsheviks that tried to do the shock therapy and tried to do the voucher privatization and created basically a form of chaos in these countries. And what people knew how to do was not supported. They felt helpless. They were disempowered. And in this chaos, then the oligarchs and the criminal elements flooded in.

And so, one of the major lessons from this is to look at it from the point of view of the population. Are the population empowered? Or are they all tarred with the same brush and as all being stained from the past? And in Eastern Europe, particularly the exiles that came back tried to say everybody in the country should be disqualified from office. And everybody is a Communist and so forth. And this aggravates the chaos, makes it much worse. So one point here is there needs to be a line drawn so that the people above that line are suspect, but the people below that line, the professional class, the technical class, scientific engineers and so forth are people that often had to join the party, Communist party in the case of Russia and Eastern Europe, the Baath party in Iraq in order to get the jobs. If they didn't, then the nomenclature would have gotten the jobs. And so, it was something that was done pragmatically. They're not ideologues, and they should be treated as technical people, professional people and now with prejudice. That is certainly one of the lessons that was brought away.

Secondly, because this is a time consuming effort to try to make this sort of a transformation, the immediate thing is to try to get some sort of working order restored, not to say well, we have to only restart things under a new premises. And so, this means something like going back to what's the last time things worked. What's the last time that the ministries worked, the last time the industries worked, and try to restore some sort of an order, even though it will not be perfect. And

the thing not to do is, as was recommended to us in Russia, don't try to jump over the chasm in one great leap. It's better to try to build a bridge over the chasm from the old to the new, even though one foot of that bridge always has to be on the old, and which may be distasteful. But the thing to avoid is to aggravate this feeling of being totally disenfranchised, totally disabled, nothing works anymore, things didn't work well before, but at least I could tinker around, I could get things to work in a haphazard way. But now things don't work at all. And this will feed into much greater chaos and extremism.

So, I want to urge a real pragmatism there and a getting away from the sort of self righteousness of a conquering army that's going to disempower everybody there and try to set up a new regime overnight. Let's be very pragmatic. And also on the -- we can talk about the privatization and some of the lessons learned there, but certainly this attempt at voucher privatization to just sort of try to wipe away everything from the past and start anew with equal rights, some sort of recompreivity (ph) of Communism almost didn't work. And that should not be even contemplated in the future.

There should be a large emphasis on restarting the enterprises that people see in their everyday life, which is the small, medium sized businesses, the retail businesses, the things that affect people's ordinary lives. And you get some sense that they're returning back to a state of normalcy. And the overall mentality here -- we were often told by the Russians that you treat us as if we were a conquered people. And the Iraqi people are in that position. So I think we have to be doubly careful in the whole projection of the American intervention there that they not be treated as the objects of benevolence and the objects of charity.

ELLERMAN: That in some sense, the way to put this and say that we should not give them aid in the sense of trying to do things for them, that we should try to put the tools in their hands and then let them rebuild their own country as much on their own than us to give out contracts and the like which would, as it were, do it for them and the great show of American benevolence, which would only preserve them in this position of being powerless and humiliated.

And then, one sort of popular point I just wanted to raise, which I think is very difficult to judge right not, but the Middle East is the only region in the world that doesn't have a regional developmental bank. That there are development banks for all the other regions of the world, and for obvious political reasons, it's been hard to do that. But if, in fact, in the future we're looking for some means of extrication, then to have a regional bank that's a cooperative effort of the nations in the region might well be something to look at.

And finally, I want to just try to get you to look at the psychology of how this is viewed from the Iraqi people, because I think they are in a very ambiguous position right now in their own psychology. Do they want to make this occupation a success, or do they not? I mean, they all want to rebuild their own country. But they're put in a position where if they cooperate with the occupying power, as in Germany, and as in Japan, well, that was 55 years ago, and we still have bases in Japan. We still have bases in Germany. And they didn't have oil. So if you're an Iraqi sitting there looking at this situation saying, do I really want this to be a success and still 50 years from now have American bases in the country or not. And so, the fundamental point has to be to somehow make that political switch so that they're not working to make the American occupation a success. They're working to rebuild their own country for themselves. And that's very difficult. I can't emphasize enough that that's going to be fundamental to the success of this effort from the point of view of the Iraqi people. Thank you.

BENNETT: Thank you very much.

Dr. Bronson?

BRONSON: Mr. Chairman, Mr. Saxton, Mr. Stark, thank you very much for the invitation to speak with you today on transforming Iraq's economy. I want to basically make four points that the transition in Iraq towards a successful economy and a successful political situation will be timely, will be dangerous, will require a resolve, it will be expensive, but ultimately, it will be worth it.

I want to make sure that we don't leave this hearing thinking that security and the security situation that, Mr. Chairman, you highlighted by holding up the newspapers is somehow distinct from the economic transformation of Iraq. They are indeed linked. And that is something that we have learned case after case, particularly in the Balkans, but really everywhere. And so, we need to focus on the security situation if we want all of our goals for the economic transformation of Iraq to succeed.

We must also remember that this is going to be very timely. Secretary of Defense Rumsfeld has pointed out that it took eight years for the United States to move from its period of revolution to a Constitution. In Germany, that experience took four years. And in Germany alone, it required \$8 billion in current dollars between 1948 and 1952. In Germany, it required a significant American and international security presence to help the Germans rebuild the law and order in their society. And it took a lot of attention to the international context to help facilitate that outcome.

So we know from the experience in the United States. We know from the experience in Germany. We know from the experience from the '90s this takes a long time. It requires international assistance and requires a serious attention to law and order.

I want to focus on law and order because it matters to this committee, both because it will be very costly to the United States, and the lack of attention has already set back Iraq's reconstruction. Much of the looting and the chaos that we've seen in the streets has largely undone all of the good works that military planners spent when they thought about what to target and what not to target. Areas that were kept off the target list have largely been destroyed by the looters. This will make it more costly. The lack of law and order also makes it harder for Iraqis to go back to work. They are afraid to leave their homes because of what may happen to their families and their property. We have to create a situation where they're more comfortable to go back to work.

The lack of law and order -- and this, I think, gets to the difference between the New York Times and the Washington Post. The Washington Post stories are focusing on the slow building back of some of the basic law and order on the street. That's very positive, and the administration can very much take credit for. But the vacuum that was created in the weeks following the war has allowed Saddam's security forces loyalists, those in the Baath party to begin reconstituting. They are organized. They do not believe this war is over. And the Iraqi people will find it very difficult to work against them if they are not convinced that Saddam and his sons are dead or that the security forces do not provide an organized opposition to the United States. The average Iraqi is waiting to see who is going to win this. And right now for them, the jury is still out.

Law and order will be a very expensive proposition. Before the war, the Council on Foreign Relations, our task force, estimated that at minimum, 75,000 troops would cost \$15 billion a year. We know that figure is now likely to be larger. The administration is on record as saying the 150,000 troops in Iraq are costing about \$3 billion a month.

The longer law and order is allowed to reign, the more costly this will be and the more difficult this will be. So I want to make sure that we focus on the connection between law and order and economic reconstruction.

But even when we get to reconstruction, even if there had been a seamless transition from our authority back to the Iraqis this still would have been expensive. Iraq's reconstruction will not be self-financing. The oil industry is in a bad situation. The papers are talking about that now. Before the war, because of sanctions and poor political leadership in Iraq over the last decade plus, Iraq was losing about 100,000 barrels per day annually. We need to staunch the bleeding of Iraq's oil industry before we can even hope to get back to the levels that they were before 1990, '91 or even the heady predictions that were made before the war.

We must remember that before the war, Iraq was bringing in about 10 to \$12 billion a year in oil. Seventy percent of that was going to the humanitarian needs of the Iraqi people, food and medicine. Three billion dollars is required to go back into the oil industry just to keep it sustainable, just to keep it operating. We estimated that the reconstruction of its oil facilities to get it back to the 3.2 million barrels per day that it was producing before the war could cost up to \$5 billion. To get its energy sector back up to where it was could cost as much as \$20 billion. Iraq was a sophisticated society with a sophisticated infrastructure. It is not like repairing Afghanistan.

There are a number of other things that will be required, and some the witnesses here today have made reference to them. And I'll quickly go through them and then leave you. First it will be required to diversify Iraq's economy. Over 95 percent of its resources come from oil. This was not the case just a few decades ago. But relying on this sole means is bad for the Iraqi people and bad for the economy. It also makes it very difficult to get to any sort of democratic future. When the leadership owns the major resource, it doesn't depend on the people to participate. And so, we need to think about the transformation of its oil sector and its larger economy if we're trying to reach any different political outcome.

Restructuring Iraq's debt is going to be a massive undertaking, and we need to show our own commitment to this process before those around the world are likely to forgive the debt. And also, we have to support a stable, transparent political order. If we want investment to flow into Iraq or if we want to keep the Iraqi money at home, there has to be something to invest in. This kind of political order will take time. If we move too quickly, the Balkans show us you get black markets, drug lords and money laundering. The administration was right to step away from the interim authority and trying to get that in too quickly. But even by bringing up the topic so early it created unnecessary expectations that have since been dashed as we have rightfully moved away from it.

The way forward is going to be very difficult in Iraq, but it is well worth doing. Iraq can be a model for the region. I receive calls from those around the region on a regular basis from our dwindling number of supporters begging us to get this right. Our supporters out there need a win that they can point to, and right now their hopes are on Iraq. And I think we should make sure that their hopes are realized. Thank you very much.

BENNETT: Thank you.

Thanks to all of you. I think you've given us the kind of provocative insight that we had hoped for. Now we have some members of the committee who did not give opening statements. If you would like to stay and question, I will allow members of the committee who did not give opening statements to question before the others do.

Did you want to take advantage of that?

HILL: I'll take advantage of that.

BENNETT: Now actually having said that, Mr. Paul was here before you were.

HILL: OK.

BENNETT: So I'd like to go in the order in which they arrived.

Mr. Paul, if you could do the first question.

PAUL: I'll let you two fight it out.

(UNKNOWN): He's yielding?

PAUL: I'll yield.

HILL: OK. Thank you.

BENNETT: All right.

Mr. Hill?

HILL: Thank you, Mr. Chairman. I don't know quite what to ask, to be honest with you. This problem -- and it is a problem -- of the state of the Iraqi people and what their future holds is obviously complicated. I mean, I woke up this morning and went jogging with my friends. I knew where my meetings were going to be. I knew where the bathroom was. I knew that I had to go to my ATM machine and get some money. None of that exists in Iraq. And first of all, when you talk about private property, how does that happen? How do people obtain this property? What mechanism is in place? What system is in place that can create private property rights for the people of Iraq? Anybody.

DE SOTO: Well, I would say that one way of looking at it without knowing Iraq, but knowing other developing countries, and what happens is that probably at this stage after all the looting, the burning, the squatting that has taken place before the Baathist revolution, the adverse possession stakes (ph), the creation of a large, small, medium enterprise situation maybe Iraq to a great extent, a great part of popular (ph) Iraq is similar to what California was 150 years ago. You had 800 mining jurisdictions that are being formed on the basis of squatting. And nobody really knew who owned what where. It took you 30 to 40 years to put that all together, because most of the property was obtained in an extra legal fashion.

So regardless of what existed before, whatever legal system existed before, you have to think of creating a new legal system to accept all the new stakeholders within the system. And that's why what I insisted upon before was how important it is to get an inventory of what has actually happened on the ground in Iraq over the last 30 years to find out where there are claims, where there are conflicting claims to make sure that whatever property system is redesigned and put into place actually serves the majority of people's interests. Otherwise we won't get the constituency to have a stable economy.

Very different than in the situation, for example, of Germany, because the property right system or the legal system that defined property rights had already been defined in the 19th century. So the occupation didn't involve really getting into the thick of that, because there was a consensus on property. In most developing countries, that consensus does not exist. What you will probably find



are widespread markets and anarchy regarding the law and therefore, the need to readapt whatever law exists to reality.

HILL: Well, I'd go back to something that Dr. Bronson had said that the people are waiting to see who is going to emerge in leadership positions. It seems to me that none of that can happen until there's some certainty in Iraq. Is that true or not true? And how long will that take? What has to be done? What should we be doing?

DE SOTO: Well, the first thing that you did in Japan, which was very interesting, or rather that the Japanese did under General MacArthur's sponsorship is have an inventory done of what the situation's all about. It took about two years to put the inventory together. In other words, underneath the feudal class of Japan, there were people who held property. But they were not within the law. Or their stakes were not recognized by the law. It took two years of an inventory to actually find out who owned what. It's the whole experience you had in all of the West of the United States. There were people that went around and tried to calculate how many trees were felled in Wyoming to create a log cabin and then find out if those would be calculated improvements and create a property law that was adequate to it.

DE SOTO: Your own Congress passed 32 preemption acts, the purpose of which was to violate an existing common law that no longer responded to the situation on the ground. The first thing you did was an inventory state by state, and then you put the law together.

AL-RAHIM (?): Mr. Hill, if I can just jump in. You know, Iraq today is a lawless country, but this is a country that was well on its way to industrialization in the '50s. There were extensive land records. There were extensive property holdings, property rights. And we are not talking about a complete breakdown of the system. Mr. De Soto may be right that we need to take some inventory, but we're not talking about starting from scratch in a complete chaotic situation. Yes, there's been looting. Yes, there's been squatting. But this comes only in the last couple of months. The problem of restitution and property rights is really going a little bit further back in terms of what's happened since the nationalizations (INAUDIBLE) of socialism that took over.

I don't think it's an insurmountable problem. It's one of the problems. And there's a lot of problems that need to be resolved.

HILL: Mr. Chairman, I see my red light is on. But thank you for the opportunity to ask a few questions.

BENNETT: Mr. Paul?

PAUL: Thank you, Mr. Chairman.

In the chairman's opening statement, he mentioned that we could be looking at Iraq either as being half full or half empty. And I tend to think that it probably is on half empty. And I sort of identify a lot with Dr. Bronson's concerns about what's going on over there.

Another concern I have is it sounds like we're in the business of nation building, which is something that lot of us talked about in the past as not being a very good idea. And it's still very popular for me in my district in Texas to say that we shouldn't be in the business of nation building. And that usually gets a pretty good response. So I have a great deal of concern about, you know, the cost of this and how well it's going. And I appreciate the testimony of all of you, because I think it gives us a lot of insight.

But I do see tremendous problems with this instilling property rights in this country. I think it's so much different than Japan and Germany. These populations were so much more homogenous compared to what we have in Iraq. So this tends to make me less pessimistic. And I'm just wondering if any of you have given any consideration to the restoration of private property rights on the original owners and the developers of the oil wells? Because in Cuba, we are concerned about that all the time. Even though it's been 40 or 50 years, there are still people who have claims about property ownership in Cuba. And I'm just wondering, I don't hear much talk about that. And it seems like maybe we should give that some consideration.

Also on the debt elimination, I think it's an academic question. I mean, they're not going to pay the debt. And it always interests me that when we talk about debt repudiation, we always have to talk about an appropriation. So if they owe us money, and they can't pay it, why don't we just write it off the books? It makes me suspect that somebody is going to get paid off that probably really doesn't deserve it. Or they should get in line. So I'm always concerned about appropriating money for debt forgiveness.

But if we did have the restoration of the implementation of private property and markets, I think the idea of capital is irrelevant. The money will go there. That's all there is to it. We don't need, you know, huge appropriations. So it is more important that we have the right rules set up, of course, by those who are there.

But my question is a political question in many ways because it seems like it's going to be so difficult to many of things. Like we have three countries over there. Iraq was an artificial country. It was designed by Europeans. It was designed after World War I. And is it conceivable that even with our occupation, our 150,000 troops, more troops now than we needed to liberate Baghdad. We need more troops. And all these billions of dollars. My question I have is how long do you think we can do this? How long will the American people tolerate it? And is it achievable?

Maybe in reality if we knew right now it was unachievable because already we've had Rumsfeld say that well, we can't have an outright election, because if it goes the wrong way and the majority would not vote what we want. So it may well be that the only solution is going to be probably three different countries there. And maybe we're fighting a losing battle. And I just wonder whether you have some comments, especially how long do you think we can go without having success? I think Mr. De Soto said we better have success. And we need to have success. So I'd like to hear your comments.

BRONSON: Mr. Paul, thank you. In terms of answering your constituency on nation building, there is a counterintuitive aspect to it that makes it understandable why everyone is so confused. The more committed and more present you are up front, the faster you can pull our boys and our girls home. And the reason for that is people are looking to go back to work. They're looking to go on the streets. They need an authority there. As long as chaos reigns, everything takes longer. Everything's more expensive.

The changing of the administration to recognize the requirements of more military police, more soldiers is actually a good sign. It bodes well that we may actually be able to pull out earlier. Because if you allow the sort of chaos because we don't have enough people and commitment there, it makes everything much harder.

Will Iraq break down into three distinct territories? If we don't stay committed, there is the possibility of it. But I think if you look back to original meetings that the opposition was having in

the early 1990s, there was a preference, for instance, in the Kurdish community among some. Their first preference was to have their own independent state. They also recognized that that was unlikely to happen. The second best alternative is participation in a full and free Iraq. We need to keep them focused on that, that their first is unattainable, but their second preference is truly attainable. And that gets back to some of these economic and political issues we're talking about.

We need to think through how the oil from the north and the south goes back to the central government, but how we also insist that it goes, once it's in the central government, back to the provinces. As long as you can get that kind of system going where the money goes in and goes back out, you will keep Iraq whole. But if there is no organization there committed to that reality, people will start fighting over keeping that oil in the north and the south, and that will be a problem for Iraq.

PAUL: You assume that it is crucial that it be kept whole. Is that correct?

BRONSON: That's right. I do. If it is not kept whole, all of the fears of the critics of this war will come to pass. And that is because if it starts fracturing, you will certainly see Turkey moving in, because they will be worried about an independent Kurdistan on its border. You will see the Iranians much more active than we are seeing now if there is going to be some sort of independent Shiite state in the south. It is crucial to the neighborhood and the United States that they remain whole. But that's a good story we all agree in the necessity of that. And it's the second preference of the Iraqis themselves, which gives us a good basis for moving forward. We have to have a centralized political authority with some independent autonomy in the provinces that allows them to benefit from that kind of vision.

DE SOTO: Yes. The only comment or reference to the issue of property claims, what has happened in many developing countries, practically in all developing countries and many former Soviet Union countries over the last 34 years is that in some cases because of natural migrations, in other cases because dictatorships also need some kind of legitimacy, and they go around redistributing land and redistributing property. And they've done that. And probably Saddam Hussein has had to do the whole thing to create legitimacy for his own regime. It is very surprising what you see once the dictator is out. The first thing you will have seen is that where one person may have owned just one estate, today there are 15,000 people living in that estate. And so, what do you do? Do you just retribute to where you were before? Do you give California back to 15 Mexican families? Or do you keep the 3 million people with big guns on them? What do you do? So what I'm saying that I think is important and it gives an idea of the time is you have to make an inventory of what has happened. I don't think that even Saddam Hussein actually knows what was happening underneath his nose. There's a whole social process that's been going into place here (ph).

When we are now, for example, working in Egypt, the logical thing, of course, is restitution. There were rent controls. Property was redistributed at the time of the revolution. They want to welcome investment again, but they find out that it's impossible, because the families that will be benefited are of small minority. And those that would be dislodged are the large majority that you need for the rule of law to come into place. How you go about that cannot even start until you have an inventory of who is where, who owns what and what are the different claims within the land so as to then start creating the kind of law that peacefully settles those conflicts and allows you to bring in stability. And that's what you in the U.S. Congress did in your own country 32 times before you created the homestead act.

There's always people who believe that the homestead act started the process whereby a large majority of Americans who had squatted now had a right to property. It was actually the last of your acts. You had 32 going before, including when President Washington had a third of his farms invaded by what he called the banditi. But first of all, you had to take stock of what had gone on. And I don't think that in many cases in Iraq anybody really knows what's going on. And that's going to take time.

BENNETT: Mr. English?

ENGLISH: Thank you very much, Mr. Chairman.

Starting with Mr. De Soto, given the natural potential of Iraq's mineral wealth, what options would you suggest to maximize the potential of the petroleum industry, since we've brought it up, in order to spur investment and growth in the overall economy in Iraq? And at the same time, how do you utilize that asset without leading to an imbalanced economy, such as you have in Venezuela where petroleum had become pretty much the only driver in the economy? Recognizing Mr. Al-Rahim's point that there has been an industrial base in Iraq, how do you use petroleum and at the same time, encourage a movement toward a strong, mixed economy?

DE SOTO: Thank you for your question. But I'm afraid I know very little about the use of petroleum. I know about successful experiments, your own in the United States in Alaska bringing a wide amount of people to participate in the wealth. I know, for example, what the Bolivians have done in terms of their gas industry and how they've made all citizens stakeholders. But I know very little about the headlines there.

ENGLISH: Mr. Al-Rahim, would you like to take a whack at that?

AL-RAHIM: Mr. English, thank you. Obviously, the oil sector is very important. But I see it important only as a catalyst for the economy. Just to put it in context, Iraq has 113 billion barrels of pure (ph) reserves. The last count or assessment of those reserves is 20 years old. It's assumed that if a new assessment is made the reserves may be as high as three times that. Putting reserves in the ground, proven (ph) reserves one and-a-half times those of Saudi Arabia and, in fact, the largest in the world.

However, reserves in the ground is something, and oil revenues is something else. As Dr. Bronson said, it takes about \$5 billion to rehabilitate the industry. And it will take probably another \$30 billion to get up to 6 million barrels a day, which at that time will give about \$35 billion of revenue a year.

You have to get the private sector to participate actively. The oil sector is not just about upstream production, of course. It's a whole world by itself as an industry. And it is a sector that will involve, not just oil field services, midstream activities and downstream activities. And the way to do it is to invite foreign participation with special protection clauses. Because, you know, for a country the size of Iraq, which today has a GDP of \$25 to \$30 billion to negotiate with a company like Exxon Mobil with an annual turnover of five times that, this is not a level playing field by any stretch of the imagination.

But you need to attract the major players. You also need to implement things that you would implement in the privatization program, which is local participation, employee share ownership programs, IPO's so as to really get that broad wealth distribution out into the country. And there are a number of methods you can do this.

ENGLISH: Very good.

Dr. Ellerman, I've been interested in the thrust of your remarks. And you have argued, as I understand it, for an incrementalist approach to building the Iraqi economy based on your experience in Eastern Europe. Can you offer us what you think would be probably the best example of how that incrementalist approach has been successful in Eastern and Central Europe since the fall of the Berlin Wall?

ELLERMAN: Well, the general idea is to try to take what I would call the defacto property rights that people have, their capabilities, their skills, what they know how to do, how they know to operate industry, how they know to make things and so forth and try to then, as it were, shrink wrap the ownership and control structure around that. So the people that have to show up at work every day to make the thing work, they have to cooperate together. So they have the control in their hands to make it work. It's very practical. Don't try to set up great, long chains of authority that have taken us decades and a century to get to work right. Try to have something more like the local ownership and the ESOP, the employee stock ownership plan that's been mentioned is an excellent way to do that.

ENGLISH: In which country in Central and Eastern Europe do you feel has most successfully undertaken that approach?

ELLERMAN: Well, all the countries used a very mixed programs. You've got to almost go program by program. But in Poland, for example, the what they call privatization by liquidation program was a type of a lease buyout. And an ESOP is like a lease buyout where the ownership goes to the management and the workers in it, but they have to pay it off over time. So it's like a lease purchase arrangement where the company itself pays it off.

Something like that also happened in Hungary which is very successful. The country that I used to live in and work in was Slovenia. And it was certainly very successful in Slovenia. So something like that is a way of empowering people, a way of getting them a stake fairly quickly. And per your question and for the previous question, this idea of us getting into nation building, what I keep trying to say is we have to get the reconstruction effort conceptualized as they're building their own nation, not as us doing nation building to them. And something like the ESOP, something like these programs where people can formalize their property rights and feel that they can then know what they can do, they're empowered to do it, and they can go further, that's the key thing, to make it their effort and not ours.

ENGLISH: Thank you.

And I need to head to the House floor. So I thank you, Mr. Chairman.

BENNETT: Thank you, sir.

Senator Sununu?

SUNUNU: Thank you, Mr. Chairman.

Mr. Al-Rahim, you mentioned the Iraqi development board, I think, one organization established in the '50s or '60s you mentioned as a good model, a good structure for coordinating and maybe identifying prospective investment. What is it about that model or that structure that works from an economic perspective or a cultural perspective?

AL-RAHIM: Mr. Sununu, that was a development board set up in the '50s independent of the government staffed by technocrats where at the time, this was prior to the revolution, the government decided to allocate 70 percent of oil revenues to this board. And the board also had the benefit of a number of prominent international economists invited to it. The attraction of that is that the revenues that came to this board were kept out of government budgets so people couldn't spill over and start using that money. And that money was really earmarked just purely for development work. I just mentioned it as one example of something that could be interesting and could work.

SUNUNU: Well, was the fact that it kept a large portion of the oil revenues out of the hands of government part of the reason for its success?

AL-RAHIM: Yes, I would say that. I mean, you didn't have government overspending spilling onto its budget, because they were kept in completely separate boxes, as it were.

SUNUNU: Mr. De Soto, you mentioned both Alaska and Bolivia. I'm familiar, I think, with the structure of the Alaskan Trust. What is the structure of the equity or revenue distribution for the Bolivian Gas Industry? And to what degree has it been successful? And to what degree could it be a model for Iraq?

DE SOTO: I'm sorry. I wouldn't have a reply to that question. (INAUDIBLE).

SUNUNU: You did mention it, though, didn't you?

DE SOTO: I mentioned that I knew of these successful experiments, but I knew no more than that.

SUNUNU: OK. Could you talk a little bit more about the experience with the inventory you need? What's the scope of that effort? Is it nationwide? Is it a pilot program? How long has it been going on? When is it expected to be completed?

DE SOTO: It's a nationwide exercise that the Egyptian government is carrying out and in which we are the technical support. It began when there was a consciousness that maybe a great part of their economy was an underground economy or an extra legal economy. And we were brought in to quantify it, to try and define it, to categorize it. And the results were surprising. That's why I was saying that it would be interesting to also carry out that kind of an exercise in Iraq. So far we've reached the point in July that there is a plan now to carry out the reforms.

There were two stages. One was the inventory. And then once you had the inventory...

SUNUNU: The inventory's complete?

DE SOTO: The inventory is as complete as you can get it now. And as I repeat, the interesting thing about the inventory is that what we found to be the extra legal economy is actually the largest part of the economy. It is bigger than their oil reserves. It is bigger than all the other industries, as I said before. It's 30 times the size of their own stock exchange and is about 70 times the size of all the bilateral aid they've received ever. So these are also, like oil resources, they're huge human capital and asset resources that are simply not put within the legal system and therefore, they cannot be mortgaged, and they cannot be leveraged, and they cannot create the wealth that they can in the United States.

SUNUNU: Has a package of reforms been proposed and adopted?

DE SOTO: The package of reforms is being proposed now. And discussions for adoption will start taking place beginning in the month of September.

SUNUNU: To what extent are you concerned that there may be political forces that work counter to the potential economic benefits here? We'll leave Egypt out of the discussion. It may or may not be foreign to this category. But one might argue that in some societies governing forces have some interest in the people holding their land or being allowed to use their land or being allowed to operate their business to a certain extent at the pleasure of the government. Property rights that are protected empower individuals, make them less dependent on the whims or the political dispositions of the leadership. So to a certain extent, might you be concerned, whether it's an Iraq or anywhere else where these kinds of land reforms are undertaken that the governing forces don't really have an interest in establishing clear, quantifiable and protected individual rights?

DE SOTO: Well, sir, in the case of the countries we've been called to, including Egypt and where we have been paid to carry out these studies, various millions of dollars, I suppose that we've been called in because people are interested in the reforms. What always spurs along the reforms is, as I repeat, the inventory. If the result of the inventory, for example, in the case of Egypt, as we were talking about, one finds out that 88 percent of businesses function outside the law, and...

SUNUNU: Leaving Egypt out, in the other case histories that you've looked at, I guess have you seen this phenomena? Or is it just a concern that hasn't been seen in the case studies? Have you seen the phenomena where sort of political forces desire to have a system where ownership rights are vague or not easily enforced?

DE SOTO: I was coming to that, sir. The thing is that when you are aware you are a politician, that in fact, you are not governing 88 percent of the people who work in the private sector because they work outside your system, that you really don't know who is living where in 90 percent of your land, you have every political interest for that to change. I have not found resistances from change coming from somebody saying well, it's all right, 90 percent can live outside the law. I don't really care if they have property rights or not. Because the consequences of not having property rights are not only the fact that you don't get development because credit, investment is all based on property rights. But it's also that you can't even police these places. You don't know where Osama bin Laden is hiding because you don't have a system of addresses. You cannot participate in the global economy.

Where the danger comes from, sir, is generally the following one. It has to do a lot with ideology and with cultural myths. So let me tell you a little bit just how we work there in just two minutes and why we're optimistic about the fact that these changes will be adopted. For example, Egypt has been trying to pass a mortgage law for many years now and has been unable to, because the forces of resistance say how are you going to have a system whereby people are able to use their homes or their chattel, their goods, their animals, their equipment to guarantee to secure a credit. Because credit only function where people have something to lose. That's what basically creates the trusts. And that's what allows you to also enforce non-compliance. And therefore, the idea is you can't impose this on poor people, therefore, you will not be able to pass a mortgage system. That has been stopping them for years and years now, if not decades.

What we do is try and look at the dark side of the economy, because it actually provides the answers in an unideological form. So we start asking, for example, how do people in this large extra legal sector of Egypt -- but we could also be talking about Mexico -- survive on a day to day

basis within their small enterprises? Do they get credit? And the reply is, they do. And the question then is how is it guaranteed. And it's guaranteed by an instrument, which, as a matter of fact, the Arabic culture created 700 years ago, which is the check system. And I think it even comes from Arabic word. There were Arab checks circulating all the way up to Shanghai 700 years ago.

So the way it would work, sir, is that if you asked me for \$12,000, I will say that the guarantee will constitute a check written against your account for that amount. Excuse me, not for that amount. But it will be drawn blank. If you do not pay, I can get you in a month or two in jail, because in all these countries, there is a debtor's jail. And a great amount of the prisoners are people who haven't paid their debts. So what we do are the statistics, which are the following ones. How many people today of Egyptians actually -- there's no mortgage law, mark you. But how many people to pay off the debt and not to go to jail have had to sell their houses? One point five percent. How many people have gone to jail and anyhow had to sell their houses? Another 4.5 percent. How many people have had to flee the region in which they live because they've not been able to pay their debts? Twenty percent. And therefore, have had to sell their houses as well. And then we put it next to, for example, U.S. statistics that say the Fanny Mae statistics I've got at least, only 0.3 percent of Americans lose their homes as a result of the mortgage system.

So then the argument becomes the following one: Not having a mortgage system violates human rights and property rights much more than having a mortgage system. But the examples that you bring are not the examples from how good this works in the United States, because then you've got (INAUDIBLE) then telling you that there's something in the Anglo Saxon gene that makes it work in the states. What you do is you compare it to the credit system that already exists for most Egyptians and in the states for most Iraqis, show how badly it works, how many more little old ladies actually lose their homes under the lack of the rule of law. And that's how you get your rule of law passed.

SUNUNU: Thank you.

Thank you, Mr. Chairman.

BENNETT: Thank you very much.

Let me try to summarize some of this, at least for me.

Mr. Al-Rahim, I'm interested to have you say that along with oil, Iraq has water and fertile land as well as a technological and professionally capable labor force. From the papers we hear about the oil, and we hear about the labor force. But we don't hear that Iraq has fertile land and water. It would seem to me that would be an enormously valuable resource in the Middle East to have fertile land and the water to cultivate it and that Iraq could not only become self-sufficient in food production for its own population, but begin to export food, if not in the Middle East, down into Africa or other places where food is desperately needed. What are the chances, in your view, of that becoming a viable economic opportunity for the Iraqis separate and apart from the oil?

AL-RAHIM: Mr. Bennett, I think it's a very viable opportunity within the context of the plan, because Iraq has been self-sufficient in the past. It doesn't even have to go as far as Africa to export, because a lot of the region, for instance, the Gulf states are net (ph) importers of food anyway. So it can just export to its own neighbors.

There are two major rivers in Iraq, the Tigris and the Euphrates. They are large rivers.



AL-RAHIM: And provided they don't get subjected to severe damning in the north in Turkey and Syria -- and there's been threats of that -- those rivers can support a very large agricultural industry in Iraq. That industry has not had any modernization brought to it like any other industry for the past 20 years for the reasons we all know. So I don't think it would be very difficult to reactivate it.

I put in my paper which is on the record at some point we need to reestablish a system of collective coops just to have the economies of scale that you need in modern agriculture operations. But I don't think that is going to be again something that is impossible or very difficult to achieve. I think it's a very viable component of the overall plan.

BENNETT: And, Mr. De Soto, that clearly would go to the question once again of property rights of who owns the land that could then be turned into agricultural activity. And maybe we don't want small farms. Maybe we want more of an agribusiness kind of approach. But that means the people who are in the way of an agribusiness acquisition of large tracts of land would have to be compensated for moving. They'd have to sell their land the way the small farmer in America sells his land to Archer Daniels Midland or whoever and takes that money and goes off to the city and becomes an entrepreneur in some other kind of a circumstance. So it seems to me there's a connection between that opportunity. And we should focus on that, because we become so preoccupied with oil, we should recognize there are many other opportunities.

I want to come back to you, Dr. Bronson, and a point which was your fourth one that I think has been lost in some of the specifics that we've gotten tied up with here when you say this is timely, dangerous, expensive and worth it. And I think we should focus on the worth it. This is, after all, the **Joint Economic Committee**. We want to talk about the impact economically on the United States. And let me just philosophize for a minute and then get your reactions, any of you.

Dr. Ellerman, you've been in this field as well. Looking back at the examples that have been talked about here, Japan and Germany at the end of the second World War, those were enormously expensive operations on the part of the United States of America. Japan at least dealt with a very, very different culture. The Germans were used to a Western style of entrepreneurial activity, the kind that would be compatible with their neighbors. The Japanese were a feudal empire.

Dr. Ellerman, MacArthur kept a bridge on the other side of the chasm. He did not eliminate the emperor. And indeed, when Japan was being bombed, they did not bomb the imperial palace. I remember as a businessman driving through the streets of Tokyo with my manager when I owned a business in Japan and looking at all of the buildings, some of which were modern skyscrapers, and some of which looked much more traditional. And I asked how many of these buildings were built since the second World War. And the answer was all of them, because every building in Tokyo with the exception of the imperial palace and the Dai-ichi (ph) Insurance Company was destroyed by the American bombs.

So MacArthur very wisely kept at least one toe on the old bridge by keeping the emperor in place, but eliminated the system of slavery. We don't realize the Japanese had slaves in the 20th century in the feudal system that they had. The woman who managed my business in Japan was part of the team. She was a translator for the American occupation forces and was part of the team that went into those areas and told these people you are now going to have property rights, told these people you are no longer slaves. How long did it take MacArthur to make that transition? Seven years? Five years? Something along that line.

How much did it cost us? I don't know. But it was huge. But, Dr. Bronson, it was obviously worth it. Japan, even with its deflation and problems now, is still the second largest national economy in the world, a major trading partner. Most Americans love Japanese cars, if nothing else. We have created an island of stability and prosperity in a part of the world that desperately needed it. And we have the opportunity to do the same thing here, create an island of stability and prosperity, property rights, proper kinds of capitalism. I remember the Russian ambassador saying to me when we were talking about some of their problems, we've had plenty of shock, but damn little therapy. And you're right. We did not do the Russian thing right. And we need to learn from that and do the Iraqi thing properly.

Am I just a rosey glasses idealist here who's looking at the best thing? Or is this in fact an enormously valuable opportunity, how difficult and dangerous and expensive and timely it may be? Is Dr. Bronson really right, everybody, that this is overwhelmingly worth all of the challenge that we need to put into it? And the advantages being very selfish, the advantages to America, to our children in terms of what could happen out of this could be as great as the advantages that came to us because our parents did what they did in Japan and Germany at the end of the second World War. Now that's a philosophical question, but I think that's what we really want to deal with in this hearing as a whole. Responses.

Mr. De Soto?

DE SOTO: Well, one reply to your question is regardless of whether that's the way it should have taken place or not taken place, your occupation of Iraq, the fact is it's done, and you're there. And now that you're there, it is an opportunity, not only because, Senator Bennett, it's an island of stability. But it's because these islands of stability are very contagious.

BENNETT: Yes.

DE SOTO: In the case of China, you didn't get it at the first throw with Chaing Hi Chek (ph). But by leaving behind the Brit's two ports with market economies and freedom, at least economic freedom, Singapore and Hong Kong, by allowing widespread property in all of these places, including Japan and what is today South Korea and what is today Taiwan, after 40 years now the larger continent is also following. It's very contagious.

If it fails, that's also contagious as well. When, for example, you have done similar things in Latin America but only for the purposes of just occupation and then withdrawing, that has not been contagious at all. So I do believe, Senator Bennett, that what happens in Iraq since the eyes of the world are upon you is going to very much determine the future of the whole Middle East and will bolster the arguments that markets and freedom are something that transcends culture or on the contrary will strengthen the hands of all of those people who say we're not all built for those kind of systems.

BENNETT: Dr. Bronson?

BRONSON: Yes, for the record, let me say that I think Dr. Bronson is right. You know, it is very important that Iraq is in the heartland of the Middle East. With all the troubles and problems that we've had since certainly September 11th with the region, but before, getting Iraq right is going to be very important to the security of the United States. We need to remember that historically Iraq has played a major role in Middle Eastern and inter Arab politics. Economically it has been an engine for the region. And culturally -- we often forget this -- the universities and the religious

establishments of Iraq have shaped the thinking of hundreds of thousands in the region. This is why many were nervous about us going into Iraq. But this is why it is so essential that we do get it right. Because the eyes of the world are on us for this.

If we get Iraq wrong, think about the challenges we're facing in the Balkans, the black markets, the drug lords, all of the problems. Multiply that for Iraq in the region of the Middle East. It will be catastrophic. But getting it wrong -- as I said in my statement, I have people calling me, begging for us to get this right. Our supporters need a win in this region. And we are there.

One of my colleagues has made the point we are occupiers. We might as well be good occupiers. There is a lot to be done, but it is doable and possible. We have to stay committed to it, though. If we don't, it all falls apart.

BENNETT: Yes. Getting it wrong, go to Haiti and see what happens when we come in. It turned out we replaced a brutal dictator much beloved of American conservatives with a brutal dictator much beloved of American liberals and left. And the people of Haiti are worse off than they were before.

Mr. Al-Rahim, you had a comment.

AL-RAHIM: Mr. Chairman, I have to tell you that I agree, not just fully with Dr. Bronson, but even more than she imagines. Because Iraq is so geopolitically important. And I'm not talking just about the benefits to the Iraqis. You know, this country made such a fuss about going into Iraq. The trumpet of changing the face of the region. There is a serious commitment to the world, not just Iraq, that was made about American intentions, American abilities and their visions for the future of this whole planet. I think to get Iraq wrong, if nothing else, is egg on the face of this nation for the next 20, 30 years. It's not like Eastern Europe. When the wall fell down, everybody looked around and said we won, turned their back and walked away. You know? And, you know, the Western Europeans had to come in, because they had to worry about primarily migration problems. So they stepped in very quickly.

Today if America does not get Iraq right, and Iraq will start a domino effect. The domino effect will start from Iraq under all circumstances. The real question is which way is that domino going to tip. And if it tips in the wrong way, don't forget Iraq's neighbors are Iran, Turkey, Saudi Arabia, Syria. Israel is not very far down the road. It's a volatile region. And if it tips the wrong way, everybody's going to feel it. We're not just talking about the Middle East anymore. And so, I think that's an added incentive of what you just very clearly and eloquently mentioned that in Japan you created an island of stability, of growth, of prosperity as an example. Because the tiger nation that eventually emerged in Southeast Asia really followed the example of Japan. That was closer to them.

And you can see that same thing happen again. I can tell you it's no secret much of the Middle East is still living in the 14th and 15th century, whether it's politically, whether it's systems of ownership, whether it's feudal mentality, et cetera, et cetera. And that has to change. The only question is will that change happen violently and in the wrong direction. Or can it happen peacefully by seeing the right example? And that's one thing that we should all be concerned about.

BENNETT: I don't think there's any question but what we are in it for the long haul. We have to stay in it for the long haul. We have to do everything we possibly can to get it right. And at the risk of speaking out of school -- but the Democrats have all gone. I was at the White House

yesterday, and at least based on the president's attitude and comments and general posture, this president is determined to stay however long it takes, spend whatever amount it costs to see to it that we get it right. And he is determined that we will not turn and leave, and we will not abandon that which we have begun. I think he understands, Mr. Al-Rahim, exactly what you're saying, that the domino can fall either way. And if it falls the wrong way, that will be a permanent stain on his presidency that George W. Bush is not willing to accept.

So based on the conversations that we had at the White House yesterday, I think the president would agree with the consensus that has emerged from this panel.

Mr. Paul, do you have any final comments of your own? You've been very faithful all the way through this.

PAUL: I have a very brief question, if I may.

I would once again like to direct it toward Dr. Bronson since she's always right. But we're talking about long and costly. Would you be willing to give us an estimate? Because we have to do some of the budgeting around here. How many troops will we have in Iraq in five years from now?

BRONSON: I think the level of 150,000 where we are now will be necessary, not just for a matter of weeks, but months.

BRONSON: And then the numbers will start to drop after a year or so. But you're not down to this sort of golden number of 30,000 very quickly. It is going to take time and numbers. To the extent to which we can work with our partners and allies who have constabulary forces and paramilitary forces, the exact kinds of forces that you need, our numbers can drop, because they will both supplement our numbers. But they also have the exact expertise that is needed. And so, therefore, you can have fewer.

But to the extent to which we have to do this alone, we will be required to stay in there with numbers, because we don't really have that expertise. We have been resistant to nation build, and therefore, haven't built the kinds of forces and troops, security services that you need. So I don't know the exact number, but I think the notion that we cannot go down below 75,000, probably for a few years. We don't get to that number of 30,000 three to five years, maybe even longer.

BENNETT: Thank you all very much. This has been a most enlightening panel. And the committee is adjourned.

END

NOTES:

[????] - Indicates Speaker Unknown

[--] - Indicates could not make out what was being said.[off mike] - Indicates could not make out what was being said.

PERSON: PAUL RYAN (72%); ROBERT F BENNETT (65%); JENNIFER DUNN (57%); RON PAUL (56%); ADAM PUTNAM (56%); JOHN SUNUNU (55%); JEFF SESSIONS (55%); ANDREW LAMAR 'LAMAR' ALEXANDER JR (54%); FORTNEY H (PETE) STARK (54%); SUSAN M COLLINS (54%); CAROLYN MALONEY (53%); BARON HILL (53%); MELVIN LUTHER WATT (53%); PAUL S SARBANES (52%); EDWARD M KENNEDY (52%); JACK REED (52%); JEFF BINGAMAN (51%);

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